BY THE SAME AUTHOR

1. REPORT ON THE ECONOMIC SURVEY OF KURUNEGALA DISTRICT (GOVERNMENT OF CEYLON)

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3. THE POST-WAR DEPRESSION AND THE WAY OUT (KITABISTAN)

THE BOMBAY PLAN

A REVIEW OF ITS FINANCIAL PROVISIONS

By

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KARNATAK PUBLISHING HOUSE

BOMBAY 2

Printed by M. N. KULKARNI at the Karnatak Printing Press, Chira Bazar, Bombay, and published by him at the Karnatak Publishing House, Chira Bazar, Bombay 2

PREFACE

The distinguished authors of the fifteen-year plan of economic development for India, now widely referred to as the Bombay Plan, have done a great service to the country by drawing our attention to the only effective method of attacking the problem of Indian poverty, which, owing to a combination of distressing factors, has earned a certain notoriety for obstinacy. The universal interest with which the plan has been acclaimed in the press and elsewhere would seem to show that there exists wide approval in the country for the view that, if we must abolish want with speed, we must set our economic machine moving by the dynamo as Russia had done. Added significance has been given to the plan by the appointment of one of its authors, Sir Ardeshir Dalal, to the Viceroy's Executive Council as member-in-charge of the newly created department of post-war planning and development.

The recent pronouncements of the Secretary of State for India, however, might possibly strengthen the misgivings of those who, for obvious reasons, are sceptical of the British Government giving its unreserved blessings to any overall plan for a large scale industrialisation of the country. In his reply to the India debate in the House of Commons, on 28 July 1944, Mr. L. S. Amery, alluding to the programme of economic regeneration of his Indian Empire, exhibited great concern for doubling our "agricultural capacity", for improving our road transport and for providing us with compulsory and free education. No reference whatever was made to the eminent desirability of forcing the pace of industrialisation of the Indian economy simultaneously.

Be this as it may, there can be nothing but praise for the objective of doubling the per capita income of the country, which, to-day, is the lowest in the world. There would be a large measure of agreement, too, on the general outline of development as laid down in the plan. The same, however, cannot be said of its financial provisions. These would seem to require a thorough reconsideration and the purpose of this pamphlet is to focus attention on this question merely.

As we shall see from the analysis of the following pages, the estimates made by the authors of the plan of the capital which may be raised from the various sources of finance are

defective in several important respects. The proposal to appropriate the sterling assets of the Reserve Bank would undermine the currency standard of the country. We would, then, be able to maintain a link neither with sterling nor directly with gold. Even apart from other considerations, this may prove detrimental to our ability to raise foreign credits for financing the plan. Their failure to recognise clearly that the balance of trade forms but part of the community's savings and that the incidence of created money, like that of voluntary saving, is upon the consumption of the citizen has led to the error of double, or, perhaps, even treble, counting. This has considerably inflated their estimate of the figure of the capital much above the level which we may expect the Indian economy to produce without engendering its own collapse. And, with utter disregard of the dangers of inflation, they propose financing the plan to the extent of Rs. 3,400 crores of created money or by several times the inflation indulged in by the state in India during the present war. Misled by fallacious reasoning they have also failed to make any provision for relieving the agriculturist of the burden of his indebtedness.

A discussion of these questions has suggested certain alternative financial proposals which we have outlined in Chapter V. The figures given therein, however, must be treated as tentative, illustrating merely the broad principles on which estimates of the capital, which may be available, must be based. But it would seem that the figure of Rs. 10,000 crores, the estimate of the authors of the plan, is far too excessive. If our analysis be any guide, the actual capacity of the Indian economy to generate capital would seem to be somewhat below half this amount.

I am obliged to Mr. Kasturbhai Lalbhai, one of the authors of the Bombay Plan, for finding the time to look into the MS and for giving me the benefit of his comments. I am thankful to him for saving me from a factual error. This must not be taken to imply, however, that he endorses my argument either as a whole or in part.

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Ahmedabad.
August 1944.

B. R. S.

CHAPTER I

THE PLAN IN BRIEF

The plan[1] has been formulated with the specific objective of raising the per capita income of the community "to such a level that after meeting the minimum requirements every individual would be left with enough resources for enjoyment of life and for cultural activities." (p. 21).[2] The present level of our income, which is assumed to be Rs. 65 per head per year, or Rs. 2,200 crores for the nation as a whole, (including Indian States), is deplorably low to permit this. It falls short of the requirements of even the bearest minimum of subsistence. With a view to giving a clear idea of the standard of living which they have aimed at, the authors of the plan have defined in terms of goods and services what, in their opinion, constitute the rock-bottom minimum demands of human life under existing conditions in India. In addition to the creature comforts of food, clothing and shelter, these include provision for medical relief and primary education. Their ideas on the subject may be set out briefly, with the estimates of their money cost *at pre-war prices*, in the table given on page 2 below.

The subsistence cost of living as stated in the last column of the foregoing table (which, it will be noted, does not include cost of several items such as fuel) works out at Rs. 74, (£ 5-11-0), per capita. The estimated income of the country, which we have quoted above, is thus insufficient to maintain its population even at the subsistence standard as defined by the authors of the plan. So as to permit a fair margin above this standard, they would, therefore, seek to increase the present level of the national income threefold, that is, from Rs. 2,200 crores to Rs. 6,600 crores, in a period of 15 years. Allowing for an increase in our population at the rate of

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1. *A Plan of Economic Development for India,* Bombay, 1944, by Sir Purshotamdas Thakurdas, J. R. D. Tata, G. D. Birla, Sir Ardeshir Dalal, Sir Shri Ram, Kasturbhai Lalbhai, A. D. Shroff and John Matthai.

2. Page references in this as in the subsequent chapters apply to the *Plan* loc. cit.

5 million per year, the rate disclosed by the last decennial census, this will yield,—it is assumed that execution of the plan will be taken in hand in 1945,—a per capita income of Rs. 135. The plan, therefore, aims at doubling our income per head per year, which should leave a margin of about Rs. 60 for enjoyment of life and for rituals of culture.

At the very outset it has been emphasised that success of this scheme entirely hinges on the emergence, at the termination of the war or shortly thereafter, of a national government

TABLE I

THE MINIMUM OF SUBSISTENCE IN PHYSICAL UNITS AND THEIR MONEY COST

	Description	Rate of cost	Aggregate cost per year in crores of rupees for 389 million people
Food	Including wastage (200 calories) in the kitchen a well balanced nutritive diet for an adult should be worth 2,800 calories per day and should be made up as under :— Cereals, 16 oz ; pulses, 3 oz ; sugar, 2 oz ; vegetables, 6 oz ; fruits, 2 oz ; fats, oils, 1·5 oz ; whole milk, 8 oz ; or meat, fish and eggs, 2·3 oz	At Rs. 65 per annum for a growing adult and very little less for a growing child	2,100
Clothing	30 yards per capita or 11,670 million yards for the entire population	At annas 3½ per yard	255
House Room	On the assumption that an individual requires 3,000 cubic feet of fresh air per hour, 100 square feet of house room per capita or a house of at least 500 square feet for a family of five	The cost of repair, upkeep and renewal estimated at 7½ per cent of the aggregate capital outlay	260

	Description	Rate of cost	Aggregate cost per year in crores of rupees for 389 million people
Public Health	One dispensary for a village of 517 with one qualified doctor and two qualified nurses, one of whom at least should be a trained midwife. For urban areas, general hospitals of 40 beds for every 10,000 of population, a maternity hospital of 30 beds for every town of 18,365 and specialised institutions for the treatment of tuberculosis, cancer, venereal diseases, mental disorders, etc., at suitable centres with an aggregate of about 150,000 beds. To this must be added provision for sanitation and water supply in the country-side as well as in the towns and cities	For the rate of running expenses see pp. 13-16 of the *Plan*	190
Education	All individuals above 10 years of age should be able to read and write. To enable this every village must have a primary school providing instruction at least up to five forms. For liquidating the prevailing adult illiteracy, literacy classes must be organised for the benefit of persons between 11 and 50 years of age	Cost of primary education at Rs. 15 per pupil per annum in rural areas and at Rs. 25 in urban areas; cost of adult education at Rs. 4 per adult; and the cost of maintaining school buildings reckoned at Rs. 7½ per cent of the capital outlay	90
		Total	2,900

at the centre with full and final powers in all economic and financial affairs. If this assumption should fail to materialise the plan can have little more than academic interest. The

maintenance of the economic unity of India and of a constitution which would permit the centre, if necessary, to override the federating units in matters affecting the prosecution and progress of the plan are also considered equally important.

The machinery for implementing the plan would comprise a National Planning Committee and a Supreme Economic Council. The former would draw up the plans and the latter would be responsible for executing them. Both bodies would function under the direction and authority of the Central Government. Details regarding the co-ordination of their activities and their relations with the federating units, however, remain to be formulated.

The threefold increase in the national income or output is sought to be realised from industry, agriculture and services in such wise that the ratios of their relative importance in the Indian economy, at the end of the period of the plan, would be altered, respectively, to 35 : 40 : 20. The corresponding ratios for the year 1931-32, the latest year for which we have an estimate of the national income, are 17 : 53 : 22. The plan, therefore, would involve an expansion of industry to six times, agriculture to 2·3 times and services to three times their present magnitude as reflected in their respective current output. By redressing the relative backwardness of industry it is proposed, therefore, to render the Indian economy more balanced than it is today. Agriculture, however, will continue to employ the larger numbers of our population.

In respect of industries the plan of development would give preference and priority in the initial stages to instrumental industries over consumption goods industries. The virtual absence of the former has been a great handicap to the progress of mechanised production in this country and it is the chief explanation of our inability to take full advantage of the opportunity offered by the present war for industrialisation. Among the instrumental industries the authors of the plan have specified the following as requiring attention :—

(1) Power—electricity ; (2) mining and metallurgy—iron and steal, aluminium, manganese, etc. ; (3) engineering—

machinery of all kinds, machine tools, etc.; (4) chemicals—heavy chemicals, fertilizers, dyes, plastics, pharmaceuticals, etc.; (5) armaments; (6) transport—railway engines and wagons, ship-building, automobile, aircraft, etc.; and (7) cement.

In this list it will be noted that electricity, which forms the main lever of industrial progress, has been given first rank. This has been done deliberately. Among the consumption trades, the range of which is vast and would constantly extend as the income of the people would increase, the following groups have been mentioned merely as an illustrative list of industries which need further development :—

(1) Textiles—cotton, silk and wool; (2) glass industry; (3) leather goods industry; (4) paper industry; (5) tobacco industry; and (6) oil industry.

The amount of capital, including paid-up capital, reserves and borrowed funds, (i.e. fixed capital plus circulating capital), required for this programme of industrialisation is estimated at about Rs. 4,480 crores. This figure is arrived at on the assumption that, on an average, the ratio, as revealed by the balance sheets of the Bombay Cotton Textile Mills, the Associated Cement Companies and the Tata Hydro-Electric Companies, between the "net product" (gross product *less* cost of raw materials and power consumed) of industries and the capital employed in them would be 1 : 2·4. It is believed that on the completion of the plan the net product of industry would be Rs. 2,240 crores (p. 24). The estimate of the capital required compares or contrasts with the estimated amount of the capital invested in industries in India in the pre-war period, excluding railways and other forms of transport, namely, Rs. 700 crores.

The development of agriculture has been planned on a lower scale than industry chiefly because it is intended in the initial years of planning not to raise primary produce for foreign markets. It is proposed, instead, to give a bias to agricultural production in favour of raising more food crops to feed the local population and more raw materials to meet the requirements of Indian industries.

Any attempt at increased agricultural production would

necessarily call for three fundamental measures of reform. First, consolidation of holdings, which have been long subject to the evils of subdivision and fragmentation, into economically effective units. Second, liquidation of the almost chronic indebtedness of the cultivators, the burden of which is far too oppressive. Third, prevention of soil erosion or the washing away of valuable top-soil by rain water, which deteriorates materially the quality of the soil and might even render it wholly unfit for cultivation. The first problem is proposed to be solved through co-operative farming for which some measure of compulsion may be necessary. The burden of indebtedness, which was estimated at Rs. 1,200 crores before the war has, probably, been reduced considerably as a result of the war-time rise in the prices of agricultural output. But the problem is far from being solved. This is proposed to be done through conciliation and co-operative credit societies. The third problem, the seriousness of which does not seem to have been noticed sufficiently widely, may be solved by terracing arable lands, through afforestation and such other measures. These obstacles removed from the path, increased agricultural production may be attained by extending the area under cultivation, by improving the yield per acre or by a combination of both devices.

Though there is, no doubt, room to claim more land under cultivation, it is considered extremely doubtful whether much of the 94 million acres, (18 per cent of British India), which Government statistics declare to be cultivable waste, is really cultivable. Vast possibilities, however, exist for improving the yield per acre, which, for practically every crop, is at present the lowest in the world and, in many cases, but a fraction of the yield in some of the foreign countries. A higher rate of output may be realised through better irrigation, a more scientific rotation of crops, employment of better seeds, more and superior quality of manure, improved varieties of implements and so on.

It is estimated that, to produce substantial results, it would be necessary to increase the aggregate area under irrigation by canals, tanks and wells by 200 per cent, from 54 million acres to 162 million acres. And, in order to bring home to the

farmer by visible demonstration the possibilities of improved methods of farming, the plan also provides for a considerable increase in the number of model farms. They would supply the farmers with quality seeds, manure, agricultural implements, bullocks and the like, besides imparting to them the necessary instruction in the use of fertilizers. They would also have a veterinary branch. The plan provides for 65,000 such model farms at the rate of one farm, on an average, for ten villages.

The aggregate capital required for effecting these improvements may be summarised in the following table :—

TABLE II

CAPITAL REQUIRED FOR IMPROVING AGRICULTURE

(Crores of Rupees)

Description	Rate of cost	Non-recurring expenditure	Recurring expenditure	Total capital
1. Soil conservation and other permanent improvements to land	—	200	10	210
2. Working capital to finance current agricultural operations	—	—	250	250
3. Irrigation—				
(i) Canals (56 million acres)	—	400	10	410
(ii) Wells, tanks, etc. (48 million acres)	—	50	—	50
4. Model farms (65,000)	Rs. 30,000 to Rs. 50,000 per farm on capital account and Rs. 20,000 for working expenses	195	130	325
	TOTAL	845	400	1,245

It will be noted that this estimate does not include any provision for liquidating agricultural indebtedness. The explanation given is that "the debt of the agriculturist represents the savings of another class and these savings would themselves be available, directly or indirectly, for financing co-operative societies" (p. 31) whose responsibility it would be to attend to this problem.

The increase in traffic, which would result from the development of industry and agriculture as outlined above, is estimated to require an extension of railways by 21,000 miles, or a 50 per cent increase in the existing mileage, and an extension of roads by 300,000 miles, or an increase of 100 per cent. Coastal shipping, which has suffered even more neglect in the past than roads, would also have to be extended and developed. A greater increase is planned in the case of roads than in the case of railways because the latter have received in the past comparatively greater attention. The idea is to give primary consideration to village roads and the feeder roads in the districts such that no village with a population of 1,000 and over would be more than a mile at most from a main highway. It is also proposed to make the use of pneumatic tyres universal for bullock carts, which is bound to remain the principal means of transport in rural areas. In addition to improving the efficiency of the bullock cart this would reduce the rate of deterioration, and, therefore, the cost of maintenance, of the roads. The road programme is also intended to include the metalling of 226,000 miles of the existing *kachcha* roads (ordinary earth roads). To facilitate the development of coastal shipping it is designed to improve the smaller natural harbours, which may be found scattered over the extensive coast lines of the country, and to equip them with adequate loading and unloading facilities. During the past few decades several of these ports have been developed or restored to use, principally in the Indian States; nevertheless, the number of ports suitable for coastal shipping remains small.

The total capital outlay required for increasing the rail and road mileage and for improving the ports may be tabulated as under :—

TABLE III

CAPITAL REQUIRED FOR IMPROVING TRANSPORT

(Crores of Rupees)

Description	Rate of cost	Non-recurring expenditure	Recurring expenditure	Total capital
1. Railways (21,000 miles)	At about Rs. 207,000 per route mile on capital account and 2 p.c. for maintenance charges	434	9	443
2. Roads (i) new construction (300,000 miles)	At Rs 10,000 per mile on capital account	300	35	335
(ii) reconstruction	At Rs 5,000 per mile on capital account	113	—	113
3. Ports	Maintenance charges at 10 per cent of cost	50	5	55
	TOTAL	897	49	946

Execution of so comprehensive a plan would require a large number of administrators, engineers, skilled workers, staff for conducting detailed surveys of the mineral riches of the country, for investigating into the possibilities of developing hydro-electric power and for carrying out scientific experiments and enquiries of various kinds. The scheme of primary and secondary education would also require a considerable number of teachers. Primary education alone would demand 1,800,000 of them. To this must be added the number of doctors and nurses essential for the maintenance of public health. Some idea of the personnel required for the plan may be had from the fact that in Soviet Russia, in 1939, these several groups of intelligentia aggregated 9,591,000 in a population of 170,000,000. It is, therefore, proposed to launch a comprehensive programme of education, including primary education, adult education, secondary and vocational education, University education,

scientific education and research. The cost of this programme may be summarised in the table below :—

TABLE IV

CAPITAL AND RECURRING EXPENDITURE ON EDUCATION
(Crores of Rupees)

Description	Rate of cost	Non-recurring expenditure	Recurring expenditure	Total capital
1. Primary education	See p. 18 of the *Plan*	85	88	174
2. Adult education	At Rs. 6 per adult	99	—	99
3. Secondary education	See p. 40 of the *Plan*	82	129	211
4. University education, scientific education and research	—	—	average 20	20
	TOTAL	267	237	504

To the several heads of capital expenditure outlined above must be added the cost of preservation and improvement of public health. It is also proposed to provide for a miscellaneous capital outlay of Rs. 200 crores.

The grand total capital expenditure of the plan as a whole may be brought together for convenience of reference as under :—

TABLE V

AGGREGATE CAPITAL OUTLAY OF THE PLAN
(Crores of Rupees)

Description	Non-recurring expenditure	Recurring expenditure	Total capital
1. Industry	4,480[1]	—	4,480
2. Agriculture	845	400	1,245
3. Communications	897	49	946
4. Education[2]	267	237	504
5. Health[2]	281	185	466
6. Housing	2,200	318	2,518
7. Miscellaneous	200	—	200
TOTAL	9,170	1,189	10,359

1. The figure of working capital is not entered under this head

As recurring expenditure, except for depreciation and replacement, is but working capital, this may be included in the estimate of the aggregate capital required for the successful completion of the plan. When the amount of the allowance made for depreciation and replacement is deducted from the above figures, the total capital requirements of the plan would amount to about Rs. 10,000 crores as under :—

	Crores of rupees
1. Industry	4,480
2. Agriculture	1,240
3. Communications	940
4. Education	490
5. Health	450
6. Housing	2,200
7. Miscellaneous	200
Total	10,000

Apart from about three to five years of preparatory work, the plan proper is scheduled to cover an aggregate of 15 years divided into three successive stages of 5 years each. As the commencement of the plan would have to be almost in vacuo the investment of capital during the first stage is deliberately kept down at Rs. 1,400 crores. The experience gained, and the general foundation laid, during this stage is expected to enable the planning of progress at a bolder pace during the second stage. Accordingly, the capital allotted to the latter is Rs. 2,900 crores or about twice the amount of the investment during the first stage. The experience and the progress realised during the first two stages would enable development at a still faster pace during the final stage. The capital assigned to it is consequently Rs. 5,700 crores or about twice the amount set apart for the second stage. This gradation of progress would also fit in with the inevitable difficulty of get-

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Footnotes continued from page 10.

separately because the ratio of 2·4, assumed for purposes of estimating the capital, includes working capital also.

2. The figures of the capital outlay on education and public health do not include provision for the probable increase in the numbers of the population during the period of the plan. The existing investment of capital under these two heads is considered sufficient to meet the requirements of such increase.

ting sufficient numbers of specialists, engineers, technicians, skilled workers and also machinery and essential materials in the early stages of the plan. They would have to be trained or produced locally, which must take time, or would have to be imported from abroad, which is limited by the available supplies of foreign exchange. As the plan progresses, however, this bottle-neck will begin to relax and, in due course, will cease to hold up the progress of the plan and of the economy. With the object of shortening this period of preparation and dependence on foreign countries it is proposed to give priority to the development of the basic industries in the earlier years of the plan.

The distribution of capital under the several heads of development over the three stages of the plan is scheduled as under :—

TABLE VI

DISTRIBUTION OF CAPITAL OVER THE THREE STAGES OF THE PLAN
(Crores of Rupees)

Description	First stage	Second stage	Third stage	Total capital
1. Industry	(790)	(1,530)	(2,160)	(4,480)
(i) Basic industry	480	1,200	1,800	3,480
(ii) Consumption goods industry	310	330	360	1,000
2. Agriculture	200	400	640	1,240
3. Communications	110	320	510	940
4. Education	40	80	370	490
5. Health	40	80	330	450
6. Housing	190	420	1,590	2,200
7. Miscellaneous	30	70	100	200
TOTAL	1,400	2,900	5,700	10,000

It is pointed out that the ratio of the capital proposed to be invested in basic industries is roughly 3·5 times the capital allotted to consumption goods industries. This ratio is smaller than the corresponding ratio in the U.S.S.R., which is indicative of the attention paid by the plan to the needs of the consumer during the period of the plan. Over-emphasis on heavy industries and on the construction of huge industrial plants,

which took years to come into operation, at the expense of consumption goods industries, state the authors of the plan, had caused great hardship and misery to the masses in Russia during the five year plans. Attention paid to the consumption trades in the plan we are considering is designed to prevent a repetition of these hardships in India. To facilitate the production of consumption goods they would take recourse to small scale and cottage industries as the capital requirements of these would be comparatively small. With the same end in view they would also plan the creation of industrial units with due regard to their economical working, to the desirability of bringing them into production within a short time and also to their amenability to regional distribution.

CHAPTER II

THE FINANCIAL PROVISIONS OF THE PLAN

As in the preceding section, here also, we shall merely attempt to state faithfully the case of the authors of the plan without comment of any sort.[1] A critical review of the financial provisions, which is our chief concern, may be deferred until the next and the subsequent chapters.

The several sources for raising the finance necessary for implementing the plan have been grouped under two heads by reference to their utility for mobilising the internal resources of the country or for acquiring resources from abroad. The latter are described as 'external finance' and the former as 'internal finance.' To quote the words of the authors of the plan, external finance is " the finance available for payment to foreign countries for goods and services imported from them while internal finance is that required within the country for the mobilization of our resources " (p. 44). As dependence on foreign countries in the early years of the plan for specialised machinery, essential materials and experts cannot possibly be avoided external finance is indispensable to the initiation of the plan and also for its progress during infancy or until such time as

1. In one place, however, it has been found necessary to make a comment of an interpretative character.

may pass before basic industries may come to be established in the country. And the raising of such finance, the volume of which is considerable, constitutes an important problem facing the planning authority. Internal finance, on the other hand, though it would, no doubt, also raise serious difficulties these are nevertheless capable of being mastered in an economy subjected to a regime of planning.

External finance would comprise the hoarded wealth of the country, mainly gold, the short-term loans advanced to the United Kingdom in the form of sterling securities held by the bank of issue, the Reserve Bank of India, the favourable balance of trade and foreign borrowing, while internal finance would be made up of the savings of the people and new moneys created "against *ad hoc* securities i.e. on the inherent credit of the government" (p. 45).

The gold hoards of the people, after making allowance for its exports since the depression of 1929, have been estimated at Rs 1,000 crores. It is assumed that a national government at the centre would be able to attract Rs 300 crores of these into the plan. The sterling assets of the issue and banking departments of the Reserve Bank, which to-day[1] amount to about Rs. 800 crores, may, if the war should continue for another year or two, grow into Rs 1,000 crores. The entire amount of these assets is proposed to be appropriated for the plan mostly in the initial stage of it.

The volume of the balance of trade which may be available must be considered in the light of the possible effect of the plan on the foreign trade of the country. As a result of the policy of reducing agricultural production for exports and also of diverting for employment in domestic industry goods normally destined for exports, the magnitude of the exports may suffer appreciable diminution. At the same time when the newly to be organised consumption goods industries begin to bear fruition and more food crops come to be raised within the country there will result a reduction in the volume of imports. It is estimated, therefore, that the normal surplus exports of the country may not fall, on an average, below Rs. 40 crores per year. As most

1. January, 1944 when the *Plan* was first published.

of India's sterling debt has been now repatriated it is hoped that the whole of this surplus would be available for financing the plan.

The authors of the plan propose to supplement the funds raised from these sources by borrowing in the foreign capital markets. India's credit in these markets stands high and we would easily be able to raise substantial amounts of capital in them, especially in America, if we so wished. There is nothing harmful in such borrowing if it does not bring with it interference of any sort on the part of foreign vested interests. The authors of the plan do not entertain any fear that the devise of " created money " for raising part of the internal finance would in any way impair the credit of the country abroad " since this finance is to be employed for promoting an expansionist economy " (p. 46). They would realise from this source Rs. 700 crores.

Savings, the volume of which would grow with the growth of the economy, form the chief source of internal finance. The standard of our average income being extremely low, and as a part of it would be taken out of our pockets through increased taxation, which a planned economy would call for, it is estimated that only 6 per cent of the national income would be available in the shape of savings for investment in the plan. If income is reckoned at Rs 2,200 crores per year this rate of saving would yield Rs 1,980 crores. But national income would not remain at this low level throughout the period of the plan. It would continually rise to the target figure of Rs. 6,600 crores. And an income of Rs. 6,600 crores should produce Rs. 5,940 crores of savings in 15 years. But this would be, clearly, an over-estimate as the target figure income would be attained only *after* the successful completion of the plan, the income *during* the period of the plan being below this figure. The actual amount of the savings that would be available would, therefore, be somewhere between the limits of Rs. 1,980 crores and Rs. 5,940 crores. The authors of the plan have put it at Rs. 4,000 crores.

This estimate of savings is considered conservative. It is hoped, therefore, that they may, in fact, accumulate at a larger percentage than that assumed in the plan. If this expectation, however, should fail to materialise they would make up the re-

maining amount necessary for balancing their budgetted expenditure, namely, Rs 3,400 crores, through "created money" in the shape of advances from the Reserve Bank against *ad hoc* securities. They see nothing unsound in this procedure as the additional money is only "meant to increase the productive capacity of the nation and in the long run is of a self-liquidating character" (p. 47).

Indeed, so far from a price raise, they anticipate that at the end of the fifteen year period, as a result of the increased output, prices would, probably, be lower than at the commencement of it notwithstanding the volume of created money. For the greater part of the duration of the plan, however, there may be a gap between the volume of the purchasing power in the hands of the public and the volume of consumption goods available in the market. It would form part of the responsibility of the planning authority to attempt to fill this gap and to keep prices within limits. It would also be necessary, in the interests of an equitable distribution, of the incidence of this method of financing, over the several classes of people, to control the various facets of the economy so rigorously "that individual liberty and freedom of enterprise will suffer a temporary eclipse" (p. 48). Successful exploitation of this source of finance, however, would depend upon the degree of public confidence and trust in the government, which further underlines the necessity of a national government at the centre.

The amount of capital which it is hoped to collect from the two groups of sources is as follows :—

	Crores of rupees	
External Finance :		
Hoarded wealth	300	
Sterling securities	1,000	
Balance of trade	600	
Foreign borrowing	700	
		2,600
Internal Finance :		
Savings	4,000	
"Created money"	3,400	
		7,400
	Total	10,000

These figures are meant only to indicate the amounts which the several sources may yield. The manner of how to raise them, whether in the form of taxation, loans floated by the government, or by voluntary public subscription to capital issues, is deferred for consideration until it may be time to put the plan into execution. For, the answer to this question would depend in large part upon the then prevailing condition of the money market and also " on the rôle to be assigned to the state in the future economy " (p. 49). It is also emphasised that, money, in which the volume of capital is expressed, must be regarded mainly as a measuring rod. What the authors of *the plan have in mind is the real resources in materials and* man-power behind their money estimates. And the rupee of their estimates is valued at the average price level which prevailed during 1931-39.

They apprehend that the capital expenditure which they have budgetted for is of such colossal dimensions that the whole scheme might seem visionary to those whose minds are still dominated by orthodox financial concepts. In support of their proposals, however, they refer to the war-time experience which, they point out, has been a great educator in this respect. They emphasise that money or finance must not be permitted to decide the economic destiny of a nation. Money is no more than an instrument for mobilising the real resources of the economy. It is a servant not master or, to use the now fashionable phrase, money is merely a camp-follower.

CHAPTER III

A CLASSIFICATION OF THE POSSIBLE SOURCES OF FINANCE

To begin with it is important to emphasise, as, indeed, has been done by the authors of the plan, that mere money or finance are in themselves incapable of furthering any plan of economic expansion. For bringing this about the authority responsible for implementing the plan must get hold of skilled (and also unskilled) workers of all kinds including specialists and managerial staff, machines and materials. Success of the plan and the speed with which it may be attained would rest upon sufficient supplies of these agents of produc-

tion being made available at the pace at which they may be required. For, it is men, machines and materials that would have to construct the canals, roads, railways, factories, machinery, buildings and such other capital goods as envisaged by the plan. Money or finance, though certainly important, are incapable of producing them on their own. They cannot, that is to say, all of a sudden, bring into being real resources which may not be there already. They can do no more than facilitate the transfer of the productive factors from the rest of the economy to the planning authority for employment in the creation of capital goods. In other words money is but an agent or vehicle for moving the factors of production from one part of the economy to another.

The aim of all methods of finance is thus to provide the planning authority with the factors of production which they may require. And the manner of how this may be done would, therefore, seem to provide a natural basis for a classification of the sources of finance. From this standpoint, broadly speaking, the sources of financing a plan of economic expansion may be said to be five-fold as under : slack factors in the economy, past investments of an obsolete character, past savings held in the form of hoards, current savings, voluntary as well as involuntary, and foreign borrowings. We shall briefly examine these several sources separately.

In most modern economies there exist, in lesser or larger measure, factors of production which are partially or wholly unemployed.[1] In Great Britain, for instance, during the interwar years, about a million idle workers had come to be regarded almost as a normal feature of the economy. It is possible to make some little progress with planning by taking them over for purposes of the plan. To the extent there may be room for doing this the normal working of the economy need not be disturbed by the execution of the plan. Creation of moneys by the banking system or the lending of idle resources lying with it for taking over the slack factors would thus provide one source of financing the plan.[2]

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1. See B. R. Shenoy, *The Post-War Depression and the Way Out*, 1944, pp. 46-49.
2. *Ibid*, pp. 111-12.

But the volume of the slack factors which may be absorbed into employment in this manner must soon get exhausted. They would be unable to take the plan beyond a certain point. Thereafter any further progress would be impossible except by drawing into the plan factors of production which are already in employment. That is to say, carpenters, weavers, farmers, domestic servants, textile labourers, workers engaged in the manufacture of consumers' goods of all kinds, etc., would have to be withdrawn from their trades for employment in the creation of capital goods as directed by the Supreme Economic Council. With the workers would have also to go such of the non-specific capital goods (e.g. implements, carts, trucks, other means of transport, power plants and machinery) as could be used, or easily adapted for use, in the new trades. There would be diverted, too, materials of common use in industries such as timber, iron and steel, agricultural raw materials, oil, coal, heavy chemicals and electricity. It is not, however, necessary that physical transfers of the men and things should take place in every case. They may, indeed, continue to work in the same factories and workshops as before. Only, instead of fashioning into shape articles of daily consumption for the market they would now be employed in producing the instruments of production and other capital goods for the planning authority.

This diversion of men, machines and materials from the general body of the consumption trades into the instrumental trades, must necessarily affect adversely, very soon, if not immediately, the volume of the stream of consumption goods flowing into the market. When this would happen, the community must suffer reduced real consumption. If we must have the plan there is no way of escape from this. No manner of economic jugglery can possibly make it otherwise. If the community would not willingly submit to reduced consumption, the means of production necessary for the prosecution of the plan cannot, with safety, be drawn away from the consumption trades. And, as they cannot be had from anywhere else in the economy, the plan may, then, have to be abandoned. Saving or reduced real consumption on the part of the community is thus an important source of finance for the plan.

It would be conducive to a speedy progress of the plan if reduced real conumption is maintained throughout the period of the plan at the level to which it would have to be lowered at the commencement of it. The newly created capital goods and other resources could, then, be wholly mobilised for purposes of furthering the plan, the increase in income which would accrue with the progress of it being added to savings instead of to expenditure on consumption. The community would agree, that is to say, to receive the augmentation of its income in the shape of the newly created capital goods. If, however, it should wish to increase the level of its real consumption during the life-time of the plan, that is, if it should demand a part of its increased income in consumption goods, some of the newly created resources would have to be employed in the consumption trades. They would not be available for purposes of capital creation and the pace of progress of the plan would be correspondingly slower.

Under hoarded wealth, the third source of finance, may be included, in addition to gold, silver, jewellery, precious stones, etc., rare works of art, collections in the museums and such other highly priced articles. As the full amount of the current savings of the community would have been already tapped, the method of mobilising these articles for the benefit of the plan must be by disposing of them in foreign countries. By selling them at home the object in view, namely, appropriating the hoards for purposes of the plan, would not be served as thereby we would only be gathering in national savings which, in any case, would be brought in by another door. The hoards of the country would, then, remain hoards. Only they will have moved from one safe or custody into another. When sold in foreign countries, however, they represent a distinct source of finance, which is apart from current savings. It would then become a means of gaining access to the real resources of foreign economies for implementing the plan.

The fourth source of finance, namely, foreign borrowing, provides another method of acquiring resources from abroad. It is immaterial whether borrowing is effected by the Supreme Economic Council, by the state or by any other institution or agency within the country. It is also immaterial what form

the borrowing may take. It would suffice if the foreign exchanges realised are made available to the planning authority. The banks, the railways or the investment trusts, for instance, may attract deposits, issue debentures or loans abroad and pass on the proceeds to the planning authority by taking over, directly or indirectly, the bonds or shares issued by the latter.

The method of drawing upon obsolete capital, which represents the fifth source of finance, is somewhat less obvious than tapping the hoards or foreign credits. To maintain these goods the entrepreneurs set apart from the proceeds of their output a depreciation fund for repair and renewal and the economy sets apart a certain amount of the agents of production with which to effect these operations. As the more modern instruments of production designed by the plan would soon replace them, it would be wasteful to bestow the same old care on these obsolete units of capital. It would suffice if they just remained in working condition so as to be able to turn out the required stream of consumption goods until it was time for the new units of capital to be commissioned into service. Excepting what may be required for effecting the minimum of repairs, the depreciation fund and the agents of production behind this fund may be appropriated for furthering the plan. The old units of capital would then be worked to exhaustion and the planning authority may be said to be employing the past investments of the community, which these units of capital represent, for purposes of the plan. The financial device of doing this is similar to the device of acquiring the factors of production made available through saving. The planning authority would first get hold of the depreciation fund in the same way as it would get hold of savings and with it engage the real resources at the back of the fund. In place of repairing or renewing the obsolete capital goods these resources would now be occupied in creating more modern and more efficient units of capital.

It may be noted that, at root, hoards, past investments, and foreign borrowings are but manifestations of the fundamental principle of saving. Hoarded wealth and old investments represent accumulations of past savings, and foreign borrowings, as they would have to be repaid from out of the savings

yet to be formed, may be said to represent future savings. When hoards are sold abroad and technicians and things are imported against them, or when the factors of production are diverted from the maintenance of capital to the creation of more elaborate capital goods, we may be said to be recapturing past accumulations of our savings for current investment. Similarly, we are but mortgaging our future savings when we utilise the proceeds of foreign loans for the execution of the plan. Though really savings in essence, hoards, past investments and foreign borrowings are yet different from currently generated savings inasmuch as, like the latter, they do not involve a diversion of the means of production away from the consumption trades of the *national economy*. This provides a justification for their separate treatment.

The slack factors in the economy, current savings, past investments of an obsolete nature, hoarded wealth and foreign borrowings exhaust the sources from which the plan might derive its sustenance. The authors of the plan we are considering have not made any reference to the first and the third of these sources and their six sources of finance would be all covered, as we shall presently see, by one or the other of the remaining three heads of our classification.

The favourable balance of trade (in which we may include visible as well as invisible items), if any, would form part of the current savings of the community. This becomes apparent when we examine the manner of how the balance of trade comes into being. It is created either by exporting the things which we abstain from consuming or by abstaining to import articles of consumption from abroad against our exports. The assets thus transferred or left behind abroad would be counted as savings by individuals to whose credit they accrue, in the same way as the unconsumed income held in the form of bank balances at home would be regarded as savings by the owners of these balances. They are the result of the abstinence from consumption on the part of the people who derive their income from foreign trade, even as the bank balances of the rest, who derive their income from exchange within the country, are the result of such abstinence. The creditor countries, notably

Great Britain, invest the surplus abroad in the same way as savings held within the country are invested in domestic trade and industry. Both investments alike are the result of saving and go to augment the national wealth and income. The balance of trade, thus, would be covered by our classification of current savings. It is not necessary, indeed, it would be incorrect, to give it a separate place as the authors of the plan we are considering have done.

The means of production raised through "created money" also belong to the same category. Created money in the hands of the Supreme Economic Council would be indistinguishable from the voluntarily accumulated savings acquired by it. Like the latter, created money, too, would draw away from the consumption trades the men and things which the planning authority may require. In both cases alike there would ensue, as a result, a reduced output of consumption goods and an equivalent fall in the level of real consumption. That is to say, voluntary savings as well as created money release factors of production from the consumption trades for the benefit of the instrumental trades through reduced real consumption on the part of the people. Looked at from this standpoint created money, therefore, is the same thing as saving. Only, whereas under voluntary saving the savers willingly forego a part of their consumption, in the case of created money reduced consumption is imposed upon the public behind their backs and without their approval. It is clear therefore that the created money of the authors of the plan would form part of our classification of current savings.

Finally, the sterling securities in the possession of the Reserve Bank, even as gold in its reserves, would fall under our classification of past savings held in the form of hoards in the same way as gold in the private hoards of the people. For, these securities embody the accumulated surplus exports of the country, visible and invisible, of the past, which, as should now be clear, form part of the then current savings. And, like gold, they are a device of gaining access to foreign economies for the benefit of the progress of the plan. They got into the possession of the Reserve Bank through the holders of the sur-

plus foreign credits, the proceeds of the surplus exports, wanting to convert their savings into Indian currency.[1]

The relationship, as disclosed by the foregoing discussion, between our classification of the sources of finance and that of the authors of the plan may be summarised as under :—

Our Classification	*Equivalent classification by the authors of the plan*
1. Slack factors	—
2. Past investments of an obsolete character	—
3. Past savings held in the form of hoards	*External Finance* : 1. Hoarded wealth 2. Sterling securities
4. Foreign borrowing	3. Foreign borrowing
5. Current savings	4. Balance of trade *Internal Finance* : 5. Savings 6. Created money

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CHAPTER IV

DOUBLE COUNTING IN THE FINANCIAL PROVISIONS OF THE PLAN

The amounts of capital, which the authors of the plan propose to raise, from the several heads of our classification as well as of their own, may be summarised below for convenience of reference :—

1. To-day these statements are correct only in the purest technical sense. For, the greater part of the sterling assets represent created money issued against them for the benefit of the British Treasury. See Shenoy, Chapter V.

TABLE VII

SOURCES OF FINANCE

(Crores of Rupees)

Our classification	Amount of Capital	Equivalent classification of the authors of the plan	Amount of Capital
1. Slack factors	Nil	—	—
2. Obsolete capital	Nil	—	—
3. Past savings held in the form of hoards	1,300	*External finance*: 1. Hoarded wealth	300
		2. Sterling securities	1,000
4. Foreign borrowing	700	3. Foreign borrowing	700
5. Current savings or reduced real consumption	8,000	4. Balance of trade	600
		Internal finance: 5. Savings	4,000
		6. "Created money"	3,400
TOTAL	10,000		10,000

It will be noted from the above table that the scheme of finance of the authors of the plan involves a collection of Rs. 8,000 crores from current savings or reduced real consumption and not, as they seem to think, merely Rs. 4,000 crores. Of the balance of the finance required by the plan they would raise, using our terms of classification, Rs. 1,300 crores from past savings and Rs. 700 crores through foreign borrowing.

The proposals of the authors of the plan to acquire Rs. 300 crores worth of our gold hoards and to raise Rs. 700 crores through foreign borrowing may be passed without comment. But it is not clear how it is designed to appropriate the sterling assets of the Reserve Bank valued at Rs. 1,000 crores. This is not quite so simple an operation as many seem to have assumed. These assets constitute the exclusive property of the Reserve Bank of India and are held by it as part of the cover against its note issue plus the liabilities of its banking department. There are only two methods of taking them over for purposes of the plan. First, to withdraw from circulation currency notes plus Reserve Bank credit of the aggregate value of Rs. 1,000 crores and second, to replace the sterling assets by Government of India rupee securities or such other *ad hoc*

paper. Neither method, as we shall presently see, is free from difficulties.

The withdrawal of notes plus bank credit, against which to claim the sterling in the possession of the Reserve Bank, would eat up Rs. 1,000 crores worth of savings. The internal financial resources of the plan would be consequently shorter by that amount and the total capital available for investment would shrink to Rs. 9,000 crores from Rs. 10,000 crores. It would be, therefore, clearly double counting to include in internal finance the amount offered to the Reserve Bank and at the same time regard the sterling securities, at present in the possession of the bank, as part of external finance. A given amount of capital can be used up but once and, while accounting, can appear but under one head.

The consequences which entail the replacement of these assets by *ad hoc* securities are of a more serious character. They would necessitate, in the first place, a change in the currency law of the country. The Reserve Bank of India Act, 1934, makes it incumbent upon the bank to hold on the asset side of its Issue Department a minimum of forty per cent of the note issue in gold or sterling securities. This law would be violated if the Supreme Economic Council were to take away to the last penny all the sterling securities. Secondly, it will also be necessary to change the standard of our currency,[1] which, unlike a change in the currency law, cannot be deemed a minor affair. Its effects would ramify over the entire economy. With no sterling in the reserve we cannot possibly maintain a sterling exchange standard. A direct link with gold, too, must be ruled out, as all the possible avenues of acquiring gold, namely, the private hoards of the people, the sterling assets of the Reserve Bank and the favourable balance of trade of the country are proposed to be tapped to capacity for the benefit of the plan. The small quantity of gold held by the Reserve Bank, which in June 1944 was worth about Rs. 44 crores,[2]

1. This necessity would be felt even under the first method of appropriating the sterling assets.

2. This value is based on the statutory price of gold, namely, Rs. 21-3-10 per tola. At the market price of Rs. 74-1-0 (which was the price on 30 June 1944) the value of the gold in the possession of the Reserve Bank would be about Rs. 140 crores. This would not, however, materially alter the line of our argument.

would be quite inadequate for meeting the demands of a direct gold standard. For the same reason a link with any other foreign currency, say, the U.S. dollar, would be also out of the question. If so, the only alternative would be a managed or unmanaged independent paper standard. This may bring with it instability in the exchange value of the rupee, which may affect adversely the credit of the country abroad and consequently the ability of the planning authority to raise capital in foreign countries. In the third place, if the securities with which to replace the sterling assets of the Reserve Bank should be Government of India rupee securities, this alternative would automatically introduce partial state ownership of the projects floated by the planning authority to the extent of Rs. 1,000 crores.

The proposal to collect Rs. 8,000 crores through reduced real consumption raises even more serious difficulties and of a fundamental character. Whether saving is the result of voluntary abstinence on the part of the people or is extorted involuntarily through created money, the incidence of it is upon the consumer. This raises the question whether, with so meagre a per capita income, we would be able to suffer a reduction in consumption on a scale necessary to produce Rs. 8,000 crores of savings in 15 years.

If we may assume that the average pace at which national income would grow during the period of the plan from an initial stage of Rs. 2,200 crores per year to the final position of Rs. 6,600 crores to be perfectly uniform, i.e. if the 'curve' of this increase would be represented by the hypotenuse of a right angled triangle, the aggregate national income for the 15 years of the plan would be half the amount of the aggregate national income for the period reckoned at the top rate of Rs. 6,600 crores per year or, roughly, Rs. 49,500 crores. At the rate of 6 per cent per annum, the rate assumed by the authors of the plan, this income may be expected to yield Rs. 2,970 crores of savings. This figure, it will be noted, falls short of the amount proposed to be collected by the authors of the plan by as much as Rs. 5,000 crores. To be able to extract Rs. 8,000 crores the rate of saving would have to be, not 6 per cent but, somewhat over 16 per cent.

This rate of saving would impose far too severe a strain upon the Indian economy. Indeed, it may break under the weight of it. Some rough idea of how severe the burden of it would be may be had when we set it against the rates at which savings have been accumulated in some foreign countries. These rates, taken from the data collected by Mr. Colin Clark,[1] may be summarised below :—

TABLE VIII

RATE OF SAVING

		Per capita income for 1928 (a)	1900-10	1913	1919-24	1925-30	1934-37
1.	U.S.A.	1,557	14·3	—	12·2	10·9	—
2.	Great Britain	1,090	12·2	—	8·1	7·6	7·0
3.	France	729	9·0	12·5	—	11·2	—
4.	Germany	675	19·1	—	—	7·7	11·8
5.	Russia	290	8·2	9·0	—	7·8	14·2
6.	India	198 (b)	—	—	—	—	—

(*a*) Figures of income are in the International Units of Mr. Colin Clark, which are defined as U. S. dollars valued at the average prices ruling between 1925-34. See *The Conditions of Economic Progress*, pp. 39-44 and 148. (b) The national income in the case of India is for the year 1932.

It will be noted from the above table that, excepting Germany during 1900-10, the savings of all the European countries, which are several times richer than India, fall short of the rate which would be imposed upon the Indian economy by the financial provisions of the plan. The point we wish to make is best illustrated by the example of Russia. With an income, which was about 50 per cent higher than that of India, a communist government, which had absolute powers of control over the consumption of the Russian citizen, did not go beyond a rate of saving of 7·8 per cent during the first five-year plan. And, during the second five-year plan, when the Russian

1. *The Conditions of Economic Progress*, London, 1940, p. 406.

national income had appreciably increased[1], the rate of savings was still under 15 per cent. In India, where, with a per capita income of Rs. 65 per year, savings must be generated mainly by forcing or inducing the starving man to eat less, and where, the power of the state over the consumer is far less absolute, it seems safest to assume savings to become available at a conservative, rather than a liberal, rate. No doubt, as the plan progresses, especially during the third five-year stage, income, and, therefore, the capacity to save, would grow. But, it must be noted that the plan proposes to increase simultaneously the output of consumption goods as well. To the extent this may be done the increased income would be eaten up in consumption. A part would be required to maintain the increased numbers of the population. It is not certain what amount may be left over for adding to the rate of saving. It would seem expedient, therefore, to stick to the 6 per cent rate and hold the surplus, if any, in reserve to meet any possible unseen increase in capital expenditure. It may not be prudent to budget for it in advance.

The inflated estimate of the volume of savings of the authors of the plan is traceable to two factors. It is due partly to their having assumed the national income to rise, during the period of the plan, at a faster pace than we have done. Their figure of the aggregate income of the community for the fifteen years of the plan is Rs. 66,700 crores, whilst ours is only Rs. 49,500 crores, a difference of Rs. 17,200 crores.

But it is due, mainly, to a double counting, or even, counting three times over, the same quantity of savings. For, they have tacitly assumed that savings, balance of trade and created money are but independent sources of obtaining capital for investment. And, on this assumption, they have added up the amount of the balance of trade and the volume of created money to the quantity of savings. We have seen in the last chapter, however, that they are but different devices of tapping the same source of finance. They refer to, and the amount of the finance they may collect is limited by, the ability of the

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1. Since the commencement of the first five-year plan in 1928, the income of Russia is estimated to have increased, during a period of 12 years, from 25 billion roubles to 125 billion roubles.

community to reduce the level of its real consumption. The balance of trade and created money are but component factors of the aggregate volume of savings in the sense of abstained consumption, whether voluntary or involuntary. It is not as if, after the capacity to save has been fully *exhausted*, capital could still be generated, as the authors of the plan seem to believe, by appropriating the balance of trade or through the medium of created money.

The amount of the balance of trade is but a manifestation of part of the community's savings, so that, if we make an estimate of the entire savings of the community, this estimate must also cover the amount of the balance of trade. That this should be so seems quite obvious. For, the balance of trade may be said to represent the remainder, after meeting the expenditure on consumption, that is after paying for the consumable goods imported, from the proceeds or income derived from exports. It may be interpreted, therefore, as the savings of the community from out of the income accruing from international trade. As this income forms part of the national income and as the moneys expended on consumable goods imported from abroad would be reckoned under the nation's expenditure on consumption, the amount of the balance of trade must necessarily form part of the aggregate savings of the community. It may, no doubt, be convenient to show the balance of trade as a separate entity, if only to give an idea of the amount of the external finance available from this source. But this cannot negative the fact that the balance of trade is embodied in the volume of savings. Likewise it would be little use attempting to generate capital through inflation after the limit of saving has been reached. A plan which relied upon such capital to any appreciable extent may never fructify and the community in which the drama of extracting it would be staged may have to suffer a fate similar to that which befell Bengal. When a pint of milk has been taken out of a pint-pot by no manner of monetary manipulation, such as created money, would it be possible to get any more milk from out of it.

It would seem clear, therefore, that to add up the balance of trade and created money to the volume of savings would amount to counting one and the same thing thrice over. And

this would seem to be how the authors of the plan have totalled up a figure of Rs. 8,000 crores when the actual amount available from this source would be in the neighbourhood of only Rs. 2,970 crores. Even if we accept the estimate of the aggregate national income of the authors of the plan, the amount of the capital, which reduced real consumption may produce, may not exceed Rs. 4,000 crores.

To the foregoing cases of double counting must be added a case of omission to make express provision for an essential item of capital expenditure, the effect of which on the financial position of the plan is similar to that of double counting. Though the authors of the plan have given due recognition to the importance of liquidating the burden of agricultural indebtedness, no provision has been made in the financial estimates of expenditure for bringing this about. As we have noted elsewhere such provision is considered superfluous since the debt of the agriculturists represents the savings of their creditors and these latter are thought to be available, directly or indirectly, to the co-operative societies for relieving indebtedness. It is not clear, however, how capital, which has been already used up by the agriculturist to finance either investment expenditure or consumption expenditure would be available back again for relieving him of the burden of his debt. For, in the one case, it will have taken the shape of some improvements to land, plough cattle or agriculural implements and, in the other, it will have been eaten up in a marriage feast or converted into miscellaneous articles of consumption. And the creditor would have with him a mortgage deed, a promissory note, or such other evidence of his having parted with his savings. If the agriculturists' indebtedness to private individuals must be replaced by indebtedness to co-operative societies, the latter must be placed in possession of fresh savings with which to buy off their present creditors. It is clearly not possible to invoke the past savings of the latter for doing this. For, as we have seen, these will have been either invested or lost and would be no longer there in the form of savings as such. In believing this feat to be possible the authors of the plan would seem to have committed yet another error which is akin to double-counting. The amount involved in it is the amount of the agricultural

indebtedness which remains to be liquidated.

Our discussion would seem to show that it is necessary thoroughly to revise the financial proposals of the plan. This we shall attempt to do in the next chapter.

CHAPTER V

REVISED FINANCIAL PROPOSALS

The discussion of the preceding chapter has disclosed that the financial provisions of the plan are defective in several important respects. First, the proposal to appropriate the sterling assets of the Reserve Bank would be destructive to the standard of our currency, whether these assets are exchanged against *ad hoc* rupee securities or against current savings. With the sterling assets taken away we would be left with no choice but to base our currency on paper, which, through its negative effect upon the credit of the country in foreign capital markets, may recoil, like a boomerang, upon the head of the planning authority itself by undermining their ability to raise credits abroad. The second method of appropriation would also mean besides that thereby no addition whatever would be made to the aggregate capital resources of the planning authority acquired from other sources. In the second place, the authors of the plan would seem to have failed to recognise clearly that the finance raised through saving, balance of trade and created money has but one common source, namely, reduced real consumption on the part of the public and that if this source is tapped to the full under the first head, no more additions could be made, to the amount so realised, from the remaining two heads. This has resulted in double, or may be, even treble, counting whereby the amount they have designed to collect from this source has been driven up by about Rs. 5,000 crores above what we consider to be the safety line. In the third place, as capital, which has been already invested or spent by the borrowers, the agriculturists, operative societies, so as to enable a transfer of their indebtedness to the latter, it is necessary to make express financial provision for lightening the burden of such indebtedness. Misled by

fallacious reasoning the authors of the plan have failed to make this provision, which, if agricultural indebtedness must go, is a serious omission.

In a revision of the financial proposals, rather than face the consequences which their appropriation would entail, it would seem vastly more expedient to leave alone the sterling assets of the Reserve Bank. As a sound currency system is a basic essential to economic progress, even as an unsound one would be a hindrance to it, these assets may, perhaps, be better employed for changing the standard of our currency from sterling to gold.[1] While this would stabilise our currency system, the opposite course proposed by the authors of the plan would upset it. Surplus assets, if any, which may be left over after the needs of the currency standard have been met in full may, however, be assigned for purposes of the plan. But to take away more than this would be to jeopardise the proposed direct link with gold which, in its turn, might prove prejudicial to unhampered progress of the plan.

Likewise, it would also be safe to steer clear of the temptation of inflationary finance. We shall examine in some detail the dangers of such finance in the next chapter. But it is important to emphasise that to indulge in it is very much like playing with fire. It seems to be far too easily forgotten, especially by people in authority, that money is not capital and that artificially created paper or bank credit can never be a substitute to the voluntarily generated savings as an agent of lasting economic progress. If there should arise any shortage of capital it is safest to make up this shortage, not by created money but, from one or more of the remaining sources of finance which we have examined in the last chapter or await further accumulations of savings. An equally commendable method would be to revise the blue-print of economic progress so as to fit in with the quantity of capital available through non-inflationary devices. To attempt to solve the problem by filling the gap with created money is the way of self-deceit and ultimate disaster.

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1. See B. R. Shenoy, "The Sterling Assets of the Reserve Bank of India", *Investment and Finance*, Annual Number, June 1944.

Though mention has been made of slack factors and obsolete capital, in our classification of the possible sources of finance, the quantity of the factors of production available under these two heads may not be appreciable. Practically the whole of the slack man-power would be unskilled and also illiterate and, therefore, mostly useless for purposes of the plan. And, in the absence of adequate information regarding the normally unused productive capacity of our industries, we may not attempt to guess the amount of the slack capital goods which could be absorbed into the plan. In any case, in an economy where the aggregate capital invested in industries (excluding railways and other forms of transport) was only about Rs. 700 crores before the war, contribution from this head cannot be considerable. The amount set apart towards depreciation and upkeep of such of our obsolete capital as would be replaced by the new capital goods to be produced under the plan is also difficult of estimation. It would relate mainly to capital invested in cottage industries and the amount is not likely to be large. The resources employed in the maintenance of capital invested in industries as a whole in Great Britain before the war was only about £ 420 million (Rs. 560 crores). The corresponding figure in respect of part of the cottage industries in India would, therefore, be but negligible. In view of these considerations we may not allot any precise figure to these two sources of finance. Such amounts of capital as they may yield, however, may be assigned to reserve with which to meet unseen demands of capital expenditure.

Slack factors, obsolete capital and created money, being thus ruled out, there remain only three heads from which to raise the capital requirements of the plan. The amounts which may be collected from each of them may be put down, in round figures, as under :—

	Crores of Rupees
Hoarded wealth	300
Foreign borrowing	700
Current savings	3,000
	4,000

Of this amount hoarded wealth, foreign borrowing and a part of current savings, namely, that represented by the

balance of trade, would constitute the sources of external finance. If we may put the figure of the balance of trade at Rs. 600 crores[1] this would amount to Rs. 1,600 crores. The remainder of Rs. 2,400 crores, comprising wholly the voluntary and induced, but not the monetarily imposed, savings, would make up internal finance. It will be noted that we have left the figures of the authors of the plan under the first two heads unchanged. But elastic elements, if any, must be sought under them, more under foreign borrowing than under hoarded wealth. Increase in the rate of current savings is a slow process linked up as it is with the rate of increase in income. It would also depend upon consumption being not allowed to increase simultaneously.

It will be noted, too, that our estimate of the capital which may be available is vastly less than that of the authors of the plan. It would be necessary, therefore, to revise the pace of expansion to fit in with this lower estimate. This would involve a climb down of the target of the plan, a fall in the aggregate national income for the period of the plan below the level of our calculation and a consequent diminution in the amount of savings which may be forthcoming. No allowance, however, has been made for this in the amount of savings we have given above. If, therefore, the aggregate capital resources must be kept at Rs. 4,000 crores adjustments corresponding to the possible deficiency in saving would have to be made from under the first two heads.

Rather than adjust the pace and scale of expansion to the

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1. It will be noted that this is the estimate of the authors of the plan. It must be borne in mind, however, that the full amount of the balance of trade, whatever may be its magnitude, would not be available for financing the plan. For, though the sterling debt of the Government of India may have been wiped out the Indian economy as a whole is by no means free from all sterling obligations. It must continue to find large amounts of sterling for meeting the claims of British nationals on account of dividend and interest on their Indian investments and also for transferring home the savings of the British civil servants and other employees in India. It is only what may be left of the balance of trade, after these obligations have been met, that would be available for the plan. The authors of the plan, however, like many others, would seem to have, somehow, missed sight of this point.

resources available, the authors of the plan would seem to have committed the serious error of first making their plan of development and then trying to find the resources for implementing it. The practice of first estimating expenditure and then finding the revenues to meet it may work with admirable success in the case of the chancellor of the exchequer so long as expenditure fell short of the taxable capacity of the subject. But if the limit of this capacity should be reached even he must cut his coat according to the cloth or be prepared to suffer the consequences of his folly. Having strained every available source to capacity, or nearly to capacity, the authors of the plan would seem to have discovered that the finances they could collect appreciably fell short of their requirements. Thereupon they proceeded to fill the gap with the required amount of created money, forgetting that this cannot bring into being non-existent factors of production to make good the deficiency in their supply which was reflected in the shortage of finances. They failed to realise, too, that even without created money their estimate of capital had got inflated as a result of double counting.

This error may not have occurred if estimates of the requirements of the plan and of the resources available had been made in terms of man-power, skilled and unskilled, instruments of capital and materials of production instead of in terms of money. No attempt might then have been made to set right any deficiency of resources discovered in terms of them through the use of the printing press. Alternatively, due regard should have been paid to the dangers of inflationary finance and also to the possibilities of double counting which economic theory has made familiar. The authors of the plan have done neither.

CHAPTER VI

THE DANGERS OF INFLATIONARY FINANCE

We shall restrict our enquiry here to the consequences of the creation of expansionary currency or credit in favour of entrepreneurs for purposes of economic expansion, since that

is our primary concern. We shall not, that is to say, occupy ourselves with the effects on the economy of the inflationary finance which a state may indulge in to make good its budgetary deficits. It may be helpful to a clear appreciation of the results of the attempts at such expansion through inflation, if we examined the processes of the change brought about when it is financed by voluntary savings. This we shall attempt to do in brief.[1]

With a view to bringing out in bold relief the nature of the changes which we wish to emphasise, let us assume increased savings to be taking place in a back-ground of economic equilibrium. Increased savings would take away from the consumption goods market an equivalent volume of money which might have, otherwise, flowed into it. Through reduced prices or reduced sales at old prices this would lead to a curtailment in the output of consumers' goods, which, in its turn, would release from the consumption trades a quantity of labour, plant and materials, hitherto engaged in producing consumers' goods but which are not any longer demanded by consumers.

Looking at the same thing from the money market and the capital market angles of vision, increased savings would add to the balances in the banks to the credit of their constituents. Anxious to maintain the level of their profits the banks would, thereupon, seek creditworthy borrowers and lower the rate of interest they charge by a margin which may be necessary for attracting borrowers. A fall in the rate of interest would be interpreted by the capital market as a signal of an increased demand, in the proximate future, for securities and real estate which will begin to be effective as soon as individual savings would grow in volume sufficiently. The available supply of these assets, however, being insufficient to meet this enhanced demand speculators would bid up their price. The rise in the price-level of capital goods would induce instrumental entrepreneurs to increase their output. This they would proceed to do by raising the necessary funds from the banking system, which, as will be clear, would be only too pleased to accommo-

1. For an outline of the evolution of the doctrine of saving and a more detailed account of the phenomenon of saving see Shenoy, Chapter I.

date them. With the help of these funds thus acquired they would engage the factors of production thrown out of work from the consumption trades. As the capital goods in the process of production mature into finished products individual savings accumulating in the banks would grow in volume and, at the appropriate time, the savers would exchange their savings for the capital goods. These would, then, be employed by them or their agents, a joint stock company, for adding to the stream of the output of consumption goods. In this manner savings, by creating capital, would enhance the community's level of consumption, that is, its standard of living.

We may now proceed to examine the effects of an attempt to bring about these results through the medium of created money.[1] As in the case of increased savings let us assume that the new money is created in a background of economic equilibrium. To be able to find an outlet for this excess supply of funds the banks would have to lower the rate of interest they charge. This would mislead the speculators into believing that an increase in the volume of savings is taking place and, as under conditions of increased voluntary saving, they would bid up the prices of securities and real estate. This, in its turn, would induce instrumental entrepreneurs to produce more capital goods. The new funds, therefore, would be acquired by them for this purpose. In the case of a pre-conceived plan of economic development, such as the one discussed in the preceding chapters, however, the newly created moneys would be taken over by the Supreme Economic Council directly, the inducements offered by the interest-price changes being unnecessary for bringing it about. But in either case the subsequent developments, which we shall now proceed to review, would be identically the same. Without any sacrifice of truth in what follows we may, therefore, refer merely to the case of credit created in favour of the Supreme Economic Council.

Unlike under an increase in voluntary saving, there would

1. Interest in this phenomenon, now widely described as the phenomenon of forced saving, has been considerably enhanced as a result of the recent developments in the theory of the business cycle. For a more detailed account of it and also for an outline of the evolution of the idea see Shenoy, Chapter II.

not, at this moment, be present in the economy labour, plant and materials, just out of work and wanting to be taken over into employment. The Supreme Economic Council, therefore, would have to attract them from the consumption trades through the inducement of higher prices. Unable to offer the same high prices the consumption trades would be compelled to surrender the factors of production required by the Council. With the help of these it would then begin to organize the creation of capital goods.

Except for a rise in factor prices, the changes produced so far would be more or less identical with the changes which follow an increase in the volume of voluntary savings. But progress in the direction initiated would be soon attended with difficulties. For, as a result of the withdrawal of the means of production from the consumption trades, the magnitude of the flow of consumption goods would begin to shrink at the end of one period of production of consumption goods. Short supply would raise the prices of these goods and the consuming public would discover that the same amount of money expenditure now brings them fewer consumption goods. Reduced consumption, however, being not of their own choice, and unwilling to submit to it, they would thereupon seek to regain their customary level of real consumption. And the higher remuneration paid to the factors of production will have placed them in funds for attempting to do so. The price-level of consumption goods would, consequently, jump up for the double reason, namely, short supply and higher money expenditure.

The rise in the price-level of consumers' goods would be the beginning of the end of the new projects financed by inflation. It would raise the profit rate in the consumption trades above their original level and would thereby bring part or whole of the newly created money into the pockets of the consumption entrepreneurs. The additional funds and the higher profits would induce these entrepreneurs to increase the scale of their output and for doing so they would outbid the instrumental entrepreneurs and reclaim into their trades the factors of production which had been, so to speak, forcibly taken away from them. This would place the Supreme Economic Council

in a serious predicament. It would find that the reduced supplies of men, machines and materials now available to it would be quite insufficient to complete the five-years' scheme of capital construction taken in hand. The financial reflex of this situation would be that, at the higher factor prices, now ruling, the balance of the created moneys remaining behind in the possession of the Council would be quite inadequate to see it through the plan. The projected capital goods in the process of production would, therefore, either have to be abandoned altogether before their completion, or, alternatively, they would have to be hastily converted into something less elaborate than had been planned at first. In either case a loss of at least a part of the capital already invested would be inevitable.

If, however, this calamity must be prevented the banks would have to be called upon to create more credit in favour of the Council and in amounts somewhat larger than the higher profit receipts of the consumption entrepreneurs. This would then enable them, through being in a position to offer sufficiently high remuneration to the factors of production, to retain these factors in their employ. It is important to note, however, that this would only postpone their difficulties, not put an end to them. For, the new moneys created would pass into the hands of the consumption entrepreneurs via the consumers' goods market almost as soon as the Council would begin to employ them to pay the higher rates of remuneration to the factors of production. When this happens the difficulty which the Council had sought to overcome would stare back again in its face.

And to prevent this it would be necessary for the banking system to go on creating credit repeatedly, at an accelerating pace, always faster than the rate at which the public's expenditure on consumption goods may increase. This process, however, cannot proceed indefinitely. If not caution, born of self-interest, the limitations imposed by the reserve ratio and the gold standard would, sooner or later, compel the banks to restrict further extensions of credit. Failure to do so might lead to a violation of the currency law and might jeopardise the standard of currency itself. And no sooner credit would be restricted than the Supreme Economic Council would find itself in hot water. If, however, these limits should be ignored and

the currency standard should be suffered to be abandoned, the economy might be faced with the danger of a complete collapse of the currency system as happened in Germany and certain other European countries after the last war. And all this might happen long before any substantial progress could be attained in the execution of the plan. It is clear, therefore, that it would be not only futile but also ruinous to attempt economic expansion through inflation.

It is not as if, created money being only "meant to increase the productive capacity of the nation", in the long run, as the authors of the plan believe, it would be "of a self liquidating character" (p. 47). That is to say, it is not as if, the aggregate output of the nation would soon increase and, thereupon, restore the ratio between goods and the money in circulation so that, once the intervening time lag has passed, there would be present no inflation whatever in the economy. Basing their argument on this reasoning, however, they anticipate that, at the end of the period of the plan, "the general level of prices would in all probability be lower than at the beginning of the plan" (pp. 46-47). In their view, therefore, the only problem, which inflationary finance would present, would be during this time lag and if, by some device, we could then "keep prices within limits" (p. 48), we will have effectively solved the problem.

This line of argument, however, suggests how completely the authors of the plan have misconceived the real character of the processes through which inflationary finance operates. As should be clear from our review of the phenomenon, its working is not quite as simple as they seem to have imagined and as some of the over-simplified versions of the crude quantity theory of money might mislead one into believing. If the reasoning underlying the argument of the authors of the plan were valid there would be no limit of prosperity to which the printing press may not take us. Actually, however, as a result of the tug of war between the consumption and the instrumental entrepreneurs, which, as we have explained, must ensue as a result of inflationary finance, orderly progress of the economy, such as that permissible under voluntary savings, would be impossible in a regime of created money. Disturbances up-

setting to such progress would begin to appear within the brief space of one production period of consumption goods.

Nor is there any device by which the evils of inflation may be securely bottled up so that the creation of capital initiated by it might continue unhampered. To achieve this impossible feat it would be necessary to prevent the consumption price-level from rising, which, as we have seen, was the starting point of the evil effects of created money. The consumption price-level could be prevented from rising only if the surplus purchasing power put into the pockets of the people by inflation is mopped up. This comes to the same thing as saying that the only method of combating the harmful consequences of inflation is to balance every inflationary issue of money by equivalent deflationary measures. And as the newly created moneys must not be permitted to remain in the pockets of the consumers long enough to enable them to bid for goods, deflation must follow close on the heels of inflation. In other words the only method of preventing the evils of inflation is not to indulge in it !

It is but idle to imagine that this can be otherwise. Any attempt to control the evils of inflation by executive decrees must either prove a failure or must inevitably lead to such a complete regimentation of the economy as to render inflation wholly superfluous to achieve the object for which recourse was had to it. It would be futile to attempt to regulate prices by issuing price-control orders so long as surplus purchasing power remained in circulation and was being continually added to. As our experience of the working of such orders during the present war has shown they can amount to no more than a farce.

To make the orders effective it would be necessary to go beyond the measures of price control and introduce nation-wide rationing over the entire range of consumption goods. But rationing cannot eliminate black markets, which must thrive whilst the people are in possession of excess moneys to spend. To prevent the means of production, which must be conserved for purposes of the plan, from being drawn away for producing goods for the black markets, it would be necessary

to take recourse to physical measures of control designed to curtail the output of consumption goods such as restricting access to transport facilities, issue of priority certificates for acquiring raw materials, rationing the supply of instrumental goods and so on. These controls must apply over every aspect of the economy if leakages in them must be avoided.

When this may happen expansionary issue of money would be quite unnecessary to finance the plan. The public would be unable to spend on consumption their incomes in excess of what costs to pay for the rational goods. And, as black markets would not now exist, they would have no alternative but to save the surplus. The savings thus accumulated must be either hoarded or invested. In either case they can be drawn into the plan, in the first through the device of, what Professor D. H. Robertson has called, "applied lacking", and in the second by blocking up all channels of investment excepting those offered by the plan. The creation of money required for bringing about applied lacking would not be expansionary in character[1] as that would only amount to salvaging the hoarded savings of the public. Investment of such moneys would be in substitution of, not in addition to, private expenditure on consumption. The new moneys would merely be in the nature of duplicates to the ones which, so to speak, had got lost or mislaid in the course of circulation. The savings of the people acquired either directly or with the collaboration of the banking system would be quite sufficient to take over for purposes of the plan the factors of production disengaged from the consumption trades. Inflation would be wholly uncalled for.

From which we see that any attempt to isolate and put out of action or into cold storage the harmful tendencies of inflation must necessarily end up in eliminating out of the economy inflation itself. And what is more the factors of production acquired for implementing the plan would, then, be made available not at all through the expansionary creation of money but through savings generated by the device of restricting the output of consumption goods. In other words either

1. See Shenoy, pp. 104-05.

we have inflation with all its evils or no inflation at all. It is quite impossible to separate the phenomenon of inflation from its evils so as to enable undisturbed progress of the plan. If, therefore, there should be room for a reduction in consumption (increase in savings) this is best mobilised for purposes of the plan by imposing appropriate physical measures of con was done in Russia, than through inflation.

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